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**BLOOMBERG BNA
EXECUTIVE SUMMARY OF THE**

**HOUSE-SENATE
COMPROMISE ON TAX
AND SPENDING BILLS**



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On December 18, President Obama signed the tax and spending compromise to keep the government funded for fiscal year 2016. As part of the tax plan, the Protecting Americans from Tax Hikes Act of 2015, makes permanent several tax provisions that were typically extended for one year. The House passed the tax portion of the agreement on December 17, 318-109. The Senate passed the package December 18, 65-33.

Individual and Family Provisions

The Bill contains numerous provisions that would benefit individuals and families. Some key tax provisions that have long been temporary would become permanent, while others would only get another temporary extension. Some of the key provisions that are being made permanent are:

- the enhanced child tax credit,
- the enhanced American opportunity tax credit,
- the enhanced earned income tax credit,
- the deduction of certain expenses for elementary and secondary school teachers, and
- the deduction for State and local general sales taxes in lieu of State and local income taxes (Division Q, §101-§105).

The permanency of these provisions should provide more certainty for individuals and families, who will no longer have to wonder whether they will still be around from year to year.

There are also several temporary extenders that would benefit individuals and families. Three provisions that are particularly important to homeowners are being extended through 2016:

- the exclusion from gross income of discharge of qualified principal residence indebtedness,
- the provision allowing mortgage insurance premiums to be treated as qualified residence interest, and
- the credit for nonbusiness energy property (Division Q, §151, §152, §181).

Health & Compensation Planning

The congressional budget deal would provide relief from certain excise taxes under the Affordable Care Act. The Bill would:

- Provide for a two-year delay on the excise tax on high-cost employer-sponsored health coverage (the “Cadillac” tax), meaning that the tax would first be effective in 2020 rather than 2018 as scheduled. The Bill would also permit the tax to be deductible as a business expense and require a study on the benchmark for the threshold measurement of the Cadillac tax. (Division P, §101-§103)
- Provide for a one-year moratorium on the annual excise tax imposed on health insurance providers for calendar year 2017. (Division P, §201)
- Prohibit the IRS and HHS from using the funds provided under the deal to support the Affordable Care Act (Division E, §113, Division H, §225, Division H, §226)

The tax extenders deal would provide additional tax relief and clarifications. The Bill would:

- Permanently extend the maximum monthly exclusion amount for transit passes and van pool benefits so that these transportation benefits match the exclusion for qualified parking benefits. (Division Q, §105)
- Modify the filing dates of returns and statements relating to employee wage information and nonemployee compensation to improve compliance. (Division Q, §201)
- Permanently extend the ability of individuals at least 70 ½ years of age to exclude from gross income qualified charitable distributions from Individual Retirement Accounts. (Division Q, § 112)
- Extend the special rule under current law for current benefits paid by accident or health plans of a public retirement system to such benefits paid by plans established by or on behalf of a state or political subdivision. (Division Q, §305)
- Allow a taxpayer to roll over amounts from an employer-sponsored retirement plan to a SIMPLE IRA. (Division Q, §306)
- Clarifies the effective dates of Public Law 113-243 to allow certain airline employees to contribute amounts received in certain bankruptcies to an IRA without being subject to the annual contribution limit. (Division Q, §307)
- Extends the relief providing an exception to the 10-percent penalty on withdraws from retirement accounts before age 50 to include nuclear materials couriers, U.S. Capitol Police, Supreme Court Police and diplomatic security special agents. (Division Q, §308)
- Clarify certain rules governing church plans, including preventing the IRS from aggregating certain church plans together for purposes of the non-discrimination rules, and providing flexibility for church plans to decide which other church plans with which they associate. (Division Q, §336)

General Business Provisions

The proposed Bill includes many business-friendly provisions. Most notably, the research and development credit would be made permanent (Division Q, §121), along with the enhanced limitations asset expensing under §179 (Division Q, §124). Numerous other provisions would get temporary extensions, some through 2016, and some through 2019.

Some of the noteworthy provisions that would be extended through 2019 are:

- the new markets tax credit,
- the work opportunity tax credit, and
- “bonus” depreciation for qualified property. (Division Q, §141-§143)

Some of the noteworthy provisions that would be extended through 2016 are:

- the Indian employment tax credit,
- the special expensing rules for certain film and television productions, and
- the energy efficient commercial buildings deduction. (Division Q, §161, §169, §190)

S Corporations

- The S corporation holding period under §1374(d)(7) for recognition of built-in gains after conversion from a C corporation would be permanently extended to 5 years. Pre-existing installment sales would continue to be governed by the holding periods for the years of sale. (Division Q, §127)
- The provision under §1367(a)(2) that upon an S corporation's charitable contribution of property, the shareholder's basis in the S corporation stock would be reduced by the shareholder's pro rata basis in the donated property (rather than the pro rata fair market value of the donated property had the provision expired) would be permanently extended. (Division Q, §115)

Regulated Investment Companies

- The provisions under §871(k) allowing a RIC to flow-through the character of qualified net interest income and qualified short-term gains to foreign shareholders by reporting such amount would be permanently extended. (Division Q, §125)
- The treatment of RICs as qualified investment entities under FIRPTA would be permanently extended. (Division Q, §133)
- Interests in RICs would not be excluded from the definition of United States real property interests. Interests in RICs would be excluded from the interests in domestic corporations, which are eligible to be excluded from the definition of United States real property interest. (Division Q, §325) (see also International, below)
- Dividends derived from RICs would be ineligible for a deduction for the United States source portion of dividends from certain foreign corporations. Dividends from RICs would be excluded from the definition of post-1986 undistributed United States earnings for purposes of determining the amount of a dividend paid by a qualified 10-percent owned foreign corporation for which a deduction is allowed. (Division Q, §326) (see also International, below)

Qualified Small Business Stock

- For taxpayers other than corporations, the exclusion from gross income under §1202 of 100% of the gain recognized on the sale or exchange of Qualified Small Business (QSB) stock held for more than five years would be permanently extended. (Division Q, §126)

Estates, Gifts, and Trusts

In the area of Estates, Gifts, and Trusts, the Bill would make permanent certain charitable deduction provisions which have been subject to one-year extensions in the past. The Bill would add some additional provisions which would either add, clarify, or enhance certain charitable contributions. The Bill would also make certain changes to the valuation of certain trusts. Finally, the Bill would make certain changes and additions with respect to the recognition, termination, and appeal rights of certain tax-exempt organizations. The following is a summary of those provisions.

- The enhanced income tax charitable deduction for certain conservation easement donations under §170(b)(1)(E) would be made permanent. (Division Q, §111(a)(1))
- The enhanced qualified conservation contribution for certain corporate farmers and ranchers under §170(b)(2)(B) would be made permanent. (Division Q, §111(a)(2))
- Add new §170(b)(2)(C) which would permit Alaska Native Corporations to deduct donations of conservation easements up to 100% of taxable income beginning in 2016. (Division Q, §111(b))
- The enhanced income tax charitable deduction for certain contributions of inventory of apparently wholesome food under §170(e)(3)(C) would be made permanent. (Division Q, §113). The Bill would also increase the limitation on deductible contributions of food inventory and provide special rules for valuing food inventory.
- Provide that charitable contributions made after the date of enactment to an agricultural research organization would be subject to the higher individual limits if the organization commits to use the contribution for agricultural research before January 1 of the fifth calendar year that begins after the date of the contribution. In addition, agricultural research organizations are treated as public charities per se, without regard to their sources of financial support. (Division Q, §331)
- Clarify the valuation method for the early termination of certain charitable remainder unitrusts for the termination of trusts made after the date of enactment. (Division Q, §344).
- Require the IRS to create procedures under which a §501(c) organization facing an adverse determination may request administrative appeal to the IRS Office of Appeals. The provision would apply to determinations made after May 19, 2014. (Division Q, §404)
- Provide a streamlined recognition process for organizations seeking tax exemption under §501(c)(4). The IRS would be required to provide a letter of acknowledgement of the registration within 60 days after an application is submitted. (Division Q, §405)
- Permit §501(c)(4) organizations and other exempt organizations to seek review in Federal court of any revocation of exempt status by the IRS. The provision applies to pleadings filed after the date of enactment. (Division Q, §405)
- Treat transfers to organizations exempt from tax under §501(c)(4), §501(c)(5), and §501(c)(6) as exempt from the gift tax for transfers made after the date of enactment. (Division Q, §408)

Reforms to Real Estate Investment Trusts

The proposed Bill would curb real estate investment trust (REIT) spinoffs, beginning December 7, 2015. In a REIT spinoff, a corporation separates its business into a taxable operating company and a real property company whose income generally is not taxable at the corporate level. The spinoff itself also is tax-free. The IRS recently has drawn attention to what it perceives to be abuses of this practice, and proposed legislation would address those concerns. With two major exceptions, spinoffs where either the distributing corporation or the controlled corporation is a REIT would no longer be eligible for tax free treatment. The first exception would be for spinoffs of a REIT by another REIT. This exception would apply where both the distributing corporation and the controlled corporation are REITs immediately

after the spinoff. The second exception would apply to spinoffs of taxable REIT subsidiaries. In this case, the distributing corporation must have been a REIT for the prior three years and the controlled corporation must have been a taxable REIT subsidiary during the same time. Neither a distributing nor a controlled corporation can elect to be treated as a REIT for ten years after a tax-free spinoff.

While tightening the rules pertaining to tax-free spinoffs, the proposed Bill would relax the Foreign Investment in Real Property Tax Act (FIRPTA) rules, which are viewed as imposing a barrier to foreign investment in U.S. real property. FIRPTA imposes income tax on foreign persons disposing of a U.S. real property interest (USRPI) and requires purchasers of those interests to withhold 10% of the sales price. The proposed Bill would raise from 5% to 10% the stake a stockholder can own in publicly traded stock of a REIT without triggering the FIRPTA withholding taxes. The Bill would also allow certain publicly traded entities to receive distributions from a REIT without the distribution being treated as gain from the sale of a USRPI.

The proposed legislation would also make numerous other changes to the REIT provisions, including modifications of the calculation of REIT earnings and profits, the rules pertaining to the types of assets a REIT may own and permissible sources of income, and the rules governing services provided by taxable REIT subsidiaries. (Division Q, §311-§326)

Reforms to the IRS and the Tax Court

The proposed Bill also includes IRS reforms to protect taxpayer rights. Beginning on the date of enactment, the IRS Commissioner would be responsible for ensuring that all IRS employees are familiar with and act in accord with taxpayer rights. Additionally, the Taxpayer Bill of Rights, as proposed by the National Taxpayer Advocate and subsequently adopted by the IRS, would be codified in the Bill. Further, the legislation would create the ability for a taxpayer who suffered an unauthorized disclosure, unauthorized inspection of returns or return information, or other offense by an officer or employee of the United States, to ascertain whether an investigation occurred, the status of an investigation, its outcome, and whether action was taken against the offending individual.

The Bill would also change several items relating to the Tax Court. One of the most significant changes would permit a taxpayer to file a Tax Court case in interest abatement matters where the IRS has failed to issue a final determination within six months. Further, the Bill would permit a taxpayer to elect small case status for interest abatement cases where the abatement does not exceed \$50,000. The legislation would also clarify provisions relating to the appeal of innocent spouse relief and collections cases. For petitions filed after the date of enactment, a Tax Court decision in these cases would be appealed to the U.S. Court of Appeals for the circuit in which an individual's legal residence is located or in which a business' principal place of business or principal office of agency is located. Additionally, when a taxpayer has filed a bankruptcy case and is prohibited from filing a Tax Court petition in innocent spouse relief and collection cases, the period for filing a petition would be suspended during the prohibition period and for an additional amount of time. (Division Q, §421-§441)

International

The Bill would change some of the rules under the Foreign Investment in Real Property Tax Act (FIRPTA) of 1980, §897 and §1445. The rate of withholding from dispositions of U.S. real property interests under §1445 would be increased from 10% to 15%, but would remain at 10% for residences sold for less than \$1 million (Division Q, §324). The Bill also would add two new relaxations of FIRPTA. First, §897 would

not apply to real property interests that otherwise would be U.S. real property interests (USRPIs) if they are held directly by qualified foreign retirement or pension funds, or if held indirectly by them through one or more partnership (Division Q, §323). Second, the Bill would increase from 5% to 10% the ownership percentage that under §897(c)(3) allows small interests in publicly traded corporations not to be considered to be U.S. real property interests (Division Q, §322). Collaterally, constructive ownership rules under §897(c)(6)(C) would not be applied to attribute ownership of public companies to or from associated persons in making this test unless shares owned by the associated person amounted to “more than 10 percent” (an increase from “more than 5 percent”) (Division Q, §322). A slight tightening of the rule treating companies that had disposed of all USRPIs as having “purged” their own shares of status as USRPIs would be implemented by requiring the company trying to purge itself of that status not to have been regulated investment companies (RICs) or real estate investment trusts (REITs) during the relevant measurement period. (Division Q, §325)

The Bill would deny a deduction for the U.S. source portion of dividends derived from RICs and REITs by adding a new paragraph (12) to §245(a). (Division Q, §326)

The Bill also includes several international-related extenders:

- Permanent extension of subpart F exception for active financing income. (Division Q, §128)
- Extension of RIC qualified investment entity treatment under FIRPTA. (Division Q, §133)
- Extension through 2019 of look-thru treatment of payments between related controlled foreign corporations under foreign personal holding company rules. (Division Q, §144)

Payroll

Payroll provisions contained in the Bill include:

- Permanent extension of qualified transportation fringe transit parity becoming permanent (and retroactive—which is not payroll-friendly). (Division Q, §105)
- Permanent extension of the military active duty wage credit. (Division, Q, §122)
- Extension and modification through 2019 of the work opportunity tax credit for first year wages paid. (Division Q, §142)
- Modification of filing dates of returns and statements relating to employee wage information and nonemployee compensation to improve compliance. (Division Q, 201)
- “Safe harbor” for incorrect information on Forms W-2 and 1099s. (Division Q, §202)